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ABSTRACT

The Oregon educational system confronts a set of legislative challenges similar to, yet different from, the rest of the nation. Like the rest of the nation, distrust of government runs high, politicians are wary of raising or restructuring taxes, the economy is expanding, and the November 1994 state election shook up the political leadership of the State. Unlike most other states, Oregon is implementing a property-tax limitation and continues to struggle with the problem of how to fund public education. This document presents an update of school-finance issues confronting the 1995-97 State Legislature, which include: (1) the impact of a statewide property-tax limitation on the state budget; (2) the move to a state-funded K-12 education system; (3) a new view of the state budget; (4) K-12 education's share of the budget; (5) state tax reduction; (6) equalization issues in the state school fund; (7) lottery funding; and (8) limits on assessed valuation growth. Three tables and a copy of the 1995-97 Governor's budget are included. (LMI)

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OREGON SCHOOL FINANCE UPDATE

Overview - State

Tucked away in the Pacific Northwest, Oregon confronts a set of Legislative challenges similar, yet different, from the rest of the nation.

Like the rest of the nation, distrust of Government runs high, politicians fear the "T" word (taxes), the economy is expanding, and the November 1994 state election shook up the political leadership of the State. Unlike most other states, Oregon is implementing a property tax limitation and continues to struggle over how to fund public education.

The major school finance issues confronting the 1995-97 State Legislature include:

1. The Impact of a Statewide Property Tax Limitation on the State Budget.
2. The Move to a State Funded K-12 Education System.
3. A New View of the State Budget.
4. K-12 Education's Share of the Budget.
5. State Tax Reduction.
6. Equalization Issues in the State School Fund.
7. Lottery Funding.
8. Limits on Assessed Valuation Growth.

A. The Impact of a Statewide Property Tax Limitation on The State Budget

The primary issue confronting the 1995 Legislature is the State's two year 1995-97 Biennial Budget. The new Democratic State Governor, John Kitzhaber, has proposed a balanced budget based on no new taxes (or changes in existing tax law) to a Republican controlled Legislature.

A balanced budget with no new taxes in a state with an expanding economy might on the surface appear a "no brainer," but Oregon has the self included pain of Ballot Measure #5. Passed by the voters in 1990, Ballot Measure 5 racheted school property taxes from an average $18 to $20 per thousand in 1990 to $5 per thousand by 1995-96, and requires the state to make up the lost property tax revenue for schools.

Therein lies the budget problem. Without Measure 5, State revenues have grown at a robust 15-20% per two year period. With Measure 5's replacement requirements, revenues grow in the 5% range per biennium. A 5% growth in funds falls short of inflation and service level increases, not to mention new programs such as the Oregon Health Plan, the Oregon School Improvement Act, or "tough on crime" ballot measures requiring more prison space.

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The result is session long battles over budget priorities in both the 1993 and 1995 legislative sessions. The major competitors for state resources include K-12 public education, higher education, health and human resources, corrections, and general state government. Revenue projections by the State economist are carefully watched for potential new revenue, legislators debate individual and corporate income taxes, and the political waters are tested to see what definition of "no new taxes" is acceptable to voters.

B. The Move to a State Funded K-12 Education System

Central to the budget debate is the move to a State funded public school system. Prior to 1990, the State share of school financing hovered in the 30% range, with the bulk of support coming from local school property taxes. As you might guess, the result was relatively high property taxes (among the top 5 states in the country), and significant variations in both effort and revenue raising ability among the State's 300 school districts. Oregon had a classic "school finance" problem, with major inequities in spending per student across the state.

Measure 5 changed all that. The focus of responsibility for school finance shifted to the State Capitol in Salem as the property tax limits effectively eliminated local control over school finance (except for General Obligation Bond issues). Due to the replacement requirements for "lost" local property tax, a major new obligation was placed on the State General Fund.

The State Legislature passed a new state school funding formula in 1991. It set a statewide goal of $4500 funding per weighted student (never reached) and adjusted for high cost students with weights of 2 for special education, 1.5 for ESL, and 1.25 for poverty students, and separately founded transportation on a 70% state basis. The formula also equalized by building all local property taxes and other designated resources into the formula, with the State paying the difference between the formula generated amount and local resources.

The Legislature now controls over 90% of most school districts' revenue. With the exception of carryover funds, investment revenues, local fees and charges, and a few categorical aids (e.g. driver education), revenue is controlled by the State through the State School Fund. Whereas Districts were dependent on local voters for property tax levies, they now wait anxiously for the Legislature to decide appropriations or make changes in the formula.

C. A New View of the State Budget

The dramatic change to nearly full state financing responsibility for K-12 education has

fundamentally changed State budgeting. An increasing share of the traditional State General Fund is needed to replace lost local property taxes under Measure 5. On the other hand, local resources for schools are essentially treated as State dollars in the State School Fund. At the same time, separate State lottery funding has mushroomed into a major State revenue source.

The New View of the State Budget is required which combines all taxes of these revenue sources (State General Fund, Local School Resources, and lottery receipts) in determining available funds for state appropriations. From the "New View" perspective, the State had an initial 5.1% increase ($480.2 million) available for 1995-97 over the 1993-95 biennium.

The new environment under Measure #5 has reduced available State funds on the Governor's proposed budget for 1995-97. As shown in Table I, the primary reason is the sharp drop in local K-14 property taxes as the property tax limit phases in.

Table 1

STATE GENERAL FUND &
K-14 LOCAL RESOURCES
1989-91 TO 1995-97
(IN MILLIONS)

BIENNIUM FUNDING 1989-91 TO 1995-97	GENERAL FUND (1)	LOTTERY FUNDS (2)	K-14 LOCAL FUNDS (3)	STATE & K-14 FUNDS (4)	% CHANGE (BIENNIUM)	$ CHANGE (BIENNIUM)
GOV.BUDGET :1995-97	$7,242.4	$707.4	$1,926.9	$9,876.7	5.1%	$480.1
PROJECTED 1993-95	$6,352.8	$357.3	$2,686.5	$9,396.5	5.3%	$476.5
APPROPRIATED FOR 1993-95	$6,400.0	$346.3	$2,590.3	$9,336.6	4.7%	$416.5
1991-1993	$5,504.7	$134.4	$3,280.9	$8,920.0	14.0%	$1,098.0
1989-1991	$4,332.5	$84.2	$3,205.4	$7,622.1	20.0%	$1,269.2

(1)SOURCE: STATE OF OREGON. GOVERNOR'S BUDGET: 1995-97
(2)SOURCE:OREGON LEGISLATIVE REVENUE OFFICE . BASIC TAX PACKET & GOVERNOR'S BUDGET 1995-97
EXCLUDES NON LOTTERY BACKFILL FUNDS OF $108 MILLION IN 1993-95 & 1995-97.
(3)SOURCE:LEGISLATIVE REVENUE OFFICE,(ASSESSMENT GROWTH FOR 1993-95 &1995-97))
EXCLUDES BONDED DEBT & STATE FUNDED TAX RELIEF.
(4)SOURCE:A NEW VIEW OF K-12 SCHOOL FUNDING,FOREST GROVE SCHOOL DT. MARCH,1994
PROJECTED INTO 1995-97 BASED ON STATE & LOCAL REVENUES.

D. K-12 Education's Share of the State Budget

When combined state and local funds are examined, K-12 education received only a 1.5% increase for 1993-95, 3.6% in the proposed Governor's budget for 1995-97. This compares to average increases of 20%% for Human Resources in 1993-95 fund a proposed 17.5% increase for 1995-97. The 1995-97 budget also contains an 8.8% increase for public safety and a 15.5% growth in General Government appropriations (see Appendix A).

In the 1995 session, the New View runs counter to the conventional wisdom and press reports that K-12 education is a priority in the Governor's budget. This misunderstanding occurs when only the traditional General Fund budget is examined, where K-12 education appropriations have increased due to the property tax replacements required under Measure 5.

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Over the last four years under the property tax limitation, the average expenditure per K-12 student has failed to keep pace with inflation. As shown in Table 2, the Governor's budget proposed school funding at a lower amount per student in 1995-96 than in 1992-93. The absence of inflation adjustment has led to budget cuts for most districts in the 1993-95, and another round of projected cuts for the 1995-97 biennium.

Table 2

YEAR	AVERAGE PER STUDENT AMOUNT	INFLATION ADJUSTED AMOUNT
1992-93	$4408	--0--
1993-94	$4116	$4562
1994-95	$4255	$4694
1995-96	$4214	$4868
1996-97	$4240	$5043

Data Source: Legislative Revenue Office, Department of Administrative Services

E. State Tax Reductions

The Governor's budget was built on a "no new tax" pledge for 1995-97. The $480 million in new revenue excluded $320 million in over projected personal income tax ($165.8 million) and corporate income tax ($152.8 million) due to Oregon's strong economy. Under existing State law, once tax collections exceed 2% over the projected amounts, the entire over projected amount is returned to tax payers.

The Governor's "no new tax" budget created a challenge for the Republican controlled Legislature. Fear of the "T" word (taxes), prevented making increases in the Governor's balanced budget, even when projected amounts for schools, prisons, court suits and other programs fell short of current service levels.

The House and Senate Republicans are struggling to come up with a short and long term solution. One option introduced by the House Revenue Committee proposed over realized taxes would be retained and a cigarette tax due to expire would be retained, but a permanent one half per cent income tax cut would be enacted beginning Jan. 1, 1996. The bottom line from this package would be a $91 million increase in available state revenues. As of early April 1995 this package did not have the backer leadership's backing.

The March 1995 revenue estimate already increased 1995-97 revenues by $55 million. Reconnecting the State income tax to the 1993 Federal tax increase would raise another $40 million.The strong State economy could also contribute to new revenues for state programs.Legislators are also hopeful added revenues will be available in the May revenue forecast, traditionally the basis for the final biennial appropriations action.

The public education community, and many other State agency programs nervously await the outcome of the tax debate. There is optimism the House Republican tax package and improved revenues could free up another $90 to $180 million for public education.

F. Equalization Issues in the State School Fund Formula

The Governor's budget promised to provide enough funding to maintain all Districts per student funding, and phase in to full equalization over a three year period. Upon closer examination, the Governor's budget fell some $300 million short of that goal.

A major reason for the short fall was raising the statewide equalization target. Portland, the largest school district in the state, with a spending level of $4660 per student, was set as the target, as opposed to the state average of $4256 per weighted student. In other words, it would take $300 million to phase all districts up to Portland's per pupil spending level in 3 years.

The target was adjusted for unique Portland costs (e.g. police/security force, desegregation funding), which lowered the estimate to $240 million for a three year phase in all districts.

These discussions became the basis of a House Revenue bill to increase school funding by $180 million over the Governor's budget. The $240 million was reduced to $180 million based on revenue considerations, and could be subject to further negotiations as the session progresses. This could cause revision of the equalization target, or lengthen the phase-in to four years.

The phase-in approach to equalization was bolstered by a Circuit Court opinion upholding the constitutionality of the state's phase-in approach to school equalization. The suit was filled by 19 equity districts seeking full equalization immediately, and is likely to be appealed to the State Supreme Court.

There is also an awareness that equalization is defined in the existing State School Fund Statute. The Legislature has explored adjustments to the formula for regional cost of education differences, but has not reached agreement on an objective factor. In addition, regional services provided by Education Service Districts, which vary significantly around the state, are not included in the current school funding formula.

Formula revisions, outside of a small school adjustment, are not likely to be tackled until the 1997 session and the next 1997-99 biennium. Studies could take place during the interim on such issues, or be the subject of a revised definition of "equalization."

G. Lottery Funding

Lottery funding is a story in itself. As in many other states, Oregon's lottery revenue has skyrocketed. Whereas in 1989-91, the State lottery produced only $84 million in revenue, projected lottery revenues are projected to exceed $700 million in 1995-97. New games, in particular video poker, have contributed to this cash cow.

The original lottery proposal passed in 1983 earmarked proceeds for economic development. Over the last decade, the definition of economic development grew to the point where prison construction was included. In effect, economic development had expanded to cover nearly any state government purpose.

The Governor proposed in his electoral campaign specifically adding education to permissible lottery expenditures. Even further, he allocated $450 million of projected lottery proceeds in 1995-97 for public school education. The Governor proposed a statewide May 1995 vote to formally add education tothe permitted uses of lottery funds in the State Constitution.

The Governor was up staged by Senate President Gordon Smith on his inauguration day. Preceding the Governor's inaugural speech, Smith proposed creating a permanent endowment fund for education including future lottery receipts, capture of the corporate income tax kicker ($131 million at that time) and sale of State assets. He appealed to Oregon's reputation for bold, imaginative long term thinking.

Smith's education endowment fund idea was watered down through the Legislative process, but some elements are likely to remain in the lottery proposed referred to the voters in May 1995. A percentage (15%) of future lottery receipts are likely to be earmarked for the endowment fund.

H. Limits on Assessed Valuation Growth

The purpose of Measure 5, Oregon's property tax limitation was to reduce property taxes. It set limits of $5 per thousand for schools and $10 per thousand for local government, or a total of $15 per thousand assessed values. These compared to combined rates of $25 to $30 per thousand in most urban areas at the time of Measure 5's passage in November 1990.

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Five years later, residential property tax payers continue to complain about property taxes. For most residential property tax payers, property taxes have remained relatively flat. There are three major reasons an anticipated drop in property taxes for homes did not occur.

a) Assessed value grew faster for residential property than for non residential (business and commercial property).

b) Oregon's relatively "hot" housing market has significantly increased the market value of residential homes.

c) Property taxes continued to increase for construction levies and local government tax growth permitted under the tax limit.

Since the passage of Ballot Measure #5, the value of single family homes grew an average 49.3% by 1993-94. Non residential property, on the other hand, grew by only 29.6% for the same period. Where prior to Measure 5, the proportion of residential and non residential were approximately equal, residential property grew to 55.3% of the total in 1993-94. The result was business property attained more tax relief under the rate based Measure 5 (see Table 3).

TABLE 3

Tax Imposed for Residential and Non-Residential Property

	Residential			Non-Residential			Total		
	Tax Imposed	Dollar Change	Percent Change	Tax Imposed	Dollar Change	Percent Change	Tax Imposed	Dollar Change	Percent Change
1985-86	934.8			881.9			1,816.7		
1986-87	982.0	47.2	5.0%	942.9	61.0	6.9%	1,924.9	108.2	6.0%
1987-88	1,041.1	59.1	6.0%	1,031.4	88.5	9.4%	2,072.5	147.6	7.7%
1988-89	1,141.8	100.7	9.7%	1,084.2	52.8	5.1%	2,226.0	153.5	7.4%
1989-90	1,219.4	77.6	6.8%	1,166.7	82.5	7.6%	2,386.1	160.1	7.2%
1990-91	1,291.4	72.0	5.9%	1,259.6	92.9	8.0%	2,551.0	164.9	6.9%
1991-92	1,367.6	76.2	5.9%	1,182.3	-77.3	-6.1%	2,549.9	-1.1	0.0%
1992-93	1,366.3	-1.3	-0.1%	1,162.7	-19.6	-1.7%	2,529.0	-20.9	-0.8%
1993-94	1,362.7	-3.6	-0.3%	1,103.7	-59.0	-5.1%	2,466.4	-62.8	-2.5%

Source:Oregon School Information Service.Taxes and Taxing Thoughts About Taxes.Vol.1,Issue 4,February,1995.

Assessed values have also grown fast by historic standards since 1990. For example, assessed value grew at 12.7% in 1994-95 and 10% in 1993-94. The housing market, fueled by a strong economy, immigration, lower prices than California or Washington, and low interest both put more property on the tax rolls and markedly increased the value of existing homes.

Voters also voted for tax increases outside Measure 5 limits. Major school construction levies passed to accommodate enrollment growth and at least partially offset the operating loses of Measure 5. The growth of assessed value also permitted local government to escape the property tax reductions faced by schools. Combined local government levies in all counties fell below the $10 limit in 1994-95. This allowed cities and counties with tax bases to continue to levy 6% tax increases with a tax base, or to approach voters for tax increases.

Pressure is building for a statewide initiative to limit assessed value growth. After 1995-96, tax bills will in most cases rise at the rate of assessed value increases on <u>each</u> property. The Oregon Tax Payers Union approached the Oregon Legislature with proposals to limit assessed value growth by 2 or 3% annually. There was initial interest, but the Legislative moved on to other tax proposals (previously mentioned). In addition, there was reluctance to tamper with the "fair market value" approach.

The Oregon Tax Payers Union, led by spokesman Bill Sizemore, has vowed to file an initiative to force a statewide vote on the issue. Their proposal would roll back 1994-95 assessed value by 15%, then permit only 2 or 3% increase in future years.

Statewide initiatives are not new to Oregonians. Spurred on by relatively easy signature requirements (approximately 83000 registered voters), and distrust of Government, Oregon had 20 initiatives on the ballot in November 1994. Nearly any statewide tax increase, or change in tax policy, ultimately requires approval by Oregon voters either by initiative or by Legislative referendum.

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A New View Revisited

1995-97: Governor's Budget

MAJOR AREA / Sub-Areas	$ Millions CURRENT 1993-95	GOVERNOR'S BUDGET 1995-97	INCREASE	% INCREASE
EDUCATION				
K-12 Education				
General Fund	$2,558.9	$3,450.0	$891.1	
Local School Revenues	$2,513.4	$1,806.7	($706.7)	
TOTAL - K-12 EDUCATION	$5,072.3	$5,256.7	$184.4	3.6%
Community College				
General Fund	$262.1	$329.2	$67.1	
Property Tax	$187.8	$134.9	($52.9)	
TOTAL - COMMUNITY COLLEGES	$449.9	$464.1	$14.2	3.2%
Higher Education	$697.8	$596.4	($101.4)	-14.5%
Department of Education				
— Operations	$18.7	$16.8	($2.0)	-10.5%
— Grants in Aid/Other	$122.7	$134.0	$11.3	9.2%
TOTAL - DEPT. OF EDUCATION	$141.5	$150.8	$9.3	6.6%
Other Education Agencies	$43.3	$30.7	($12.6)	-29.1%
▪ *TOTAL EDUCATION*	$6,405.0	$6,498.7	$93.7	1.5%
HUMAN RESOURCES				
Mental Health	$433.6	$393.5	($40.1)	-9.3%
Director/Health Plan	$462.6	$720.4	$257.8	55.7%
Adult & Family Services	$288.2	$304.4	$16.2	5.6%
Senior & Disabled	$271.2	$306.3	$35.1	12.9%
CSD/Youth Authority	$198.9	$244.0	$45.1	22.7%
Other	$79.2	$68.3	($10.9)	-13.8%
▪ *TOTAL HUMAN RESOURCES*	$1,733.7	$2,036.9	$303.2	17.5%
PUBLIC SAFETY				
Corrections	$352.6	$393.8	$41.3	11.7%
Judicial	$256.1	$277.2	$21.1	8.3%
State Police	$123.7	$122.5	($1.2)	-0.1)
District Attorneys	$7.7	$7.1	($0.6)	-7.3%
Other	$25.8	$24.5	($1.3)	-5.0%
▪ *TOTAL PUBLIC SAFETY*	$765.8	$825.1	$59.3	7.7%
NATURAL RESOURCES	$131.7	$116.2	($15.5)	-11.7%
TRANSPORTATION/ECO.DEV.	$148.5	$155.1	$6.6	4.4%
GENERAL GOVERNMENT	$211.8	$244.6	$32.8	15.5%
TOTAL	$9,396.5	$9,876.7	$480.2	5.1%

SOURCES:
1. STATE OF OREGON, 1995-97 GOVERNOR'S BUDGET.
2. STATE EXECUTIVE DEPARTMENT, LOTTERY FUNDS.

January 1995

Prepared by Forest Grove School District